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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1033

DAKOTA TRACTOR & EQUIPMENT COMPANY, A CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The District Court rendered no opinion. The opinion of the Circuit Court of Appeals (R. 98-108) is reported in 125 F. (2d) 20.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 7, 1942 (R. 108-109). A petition for rehearing was denied February 3, 1942 (R. 117). The petition for a writ of certiorari was filed March 11, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a written contract prohibiting taxpayer from making cash dividend payments only, but allowing other dividend payments, entitled it to the credit allowed by Section 26 (c) (1) of the Revenue Act of 1936 in the computation of surtax on undistributed profits imposed by Section 14 of that Act.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) *Contracts restricting payment of dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26-2. *Credit in connection with contracts restricting payment of dividends.*—

(a) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. * * *

* * * * *

(b) *Prohibition on payment of dividends.*—The credit provided in section 26 (c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. If an amount can be distributed within the taxable year as a dividend—

(1) in one form (as, for example, in stock or bonds of the corporation) without violating the provisions of a contract, but cannot be distributed within the taxable year as a dividend in another form (as, for example, in cash) without violating such provisions, * * *

* * * * *

then the amount is one which, under section 26 (c) (1), can be distributed within the taxable year as a dividend without violating such provisions.

STATEMENT

The facts as found by the District Court (R. 85-90) may be summarized as follows:

On May 27, 1935, petitioner and the Caterpillar Tractor Company executed a "Distributor's Sales and Service Agreement" under which petitioner was granted the right to act as distributor for the products of Caterpillar in a designated territory (R. 11-26, 86). This agreement did not include any provision dealing with the payment of dividends (R. 11-26), and was expressly stated to be the entire contract of the parties (R. 25). The District Court, however, admitted in evidence a letter dated May 13, 1935, which stated certain "policies" that the petitioner would carry out in the event that a distributor's agreement should be signed, and which the District Court found that Caterpillar had required before it would execute the distributor's agreement (R. 62, 81, 82-84, 90). Among the "policies" stated in that letter were the following (R. 82, 83-84):

3. The authorized capital stock of the company will be increased from \$50,000.00 to \$100,000.00 as promptly as possible.

* * * * *

5. Through the declaration of stock dividends or other satisfactory means the present surplus will be converted to paid-in capital stock of the company so that the outstanding capital stock will be increased to \$65,000.00.

* * * * *

All profits shall remain in the business and from time to time the earned surplus will be converted into paid-in capital through the declaration of stock dividends or otherwise.

As there is no desire to adversely affect the financial position of the company there shall be no cash withdrawals from the business in the form of cash dividends or otherwise until entire authorized capital stock of \$100,000.00 has been paid in.

As it is the desire of the company to become financially self-sustaining, and to operate the business in a manner that will meet the requirements of all of the manufacturers represented, particularly Caterpillar Tractor Co., the approval of Caterpillar Tractor Co. will be obtained before any cash is withdrawn from the business, even after the authorized capital of \$100,000.00 is paid in, unless at such time the business is actually fully self-sufficient financially and does not owe any money to Caterpillar Tractor Co.

If the volume of the business engendered shall justify increase of the net worth of the business above \$100,000.00, as it is expected will be the case, the authorized capital stock shall later be increased from time to time as may seem to be advisable and further earnings or additional cash be invested in the business and capital stock issued therefor until such time as the business becomes fully self-sufficient financially.

On January 1, 1936, the authorized capital stock of petitioner was \$100,000, consisting of 1,000 shares of common stock of \$100 par value, of which 325 shares were issued and outstanding. As a result of stock dividends authorized and issued during 1936, and a small aggregate of sales of common stock, \$100,000 of the petitioner's authorized capital stock was issued and outstanding on December 31, 1936 (R. 86).

The District Court concluded that the distributor's agreement and letter constituted a contract under which a credit was allowable to the petitioner in computing its surtax on undistributed profits (R. 90-91), and entered judgment for refund to the petitioner (R. 91). The Circuit Court of Appeals reversed (R. 108-109). A petition for rehearing was filed by the petitioner on January 28, 1942 (R. 111-116), and was denied by the Circuit Court of Appeals on February 3, 1942 (R. 117).

ARGUMENT

The decision of the court below is correct and no further review is warranted.

The agreement between petitioner and the Caterpillar Tractor Company, viewed in a light most favorable to petitioner, restricts the payment only of cash dividends (R. 106). Under the agreement, payment of stock dividends was, in fact, required (R. 106), and such dividends were

paid by petitioner during the taxable year (R. 86).

Petitioner apparently contends (Pet. 5) that a credit is due under Section 26 (c) (1) in any case when the contract prohibits an "asset-distribution" and that, therefore, it is entitled to the credit in the instant case since the contract, while contemplating stock dividends, prohibited payment of cash dividends. This contention is without merit.

The unambiguous terms of Section 26 (c) (1) require that before the credit becomes operative, there must be a contractual restriction against distribution of "dividends." There is no room for construing its clear provisions as applicable only to cash dividends, and, accordingly, the Commissioner, has expressly so recognized. Article 26-2 (b) (1), Regulations 94, *supra*. It is plain that Section 26 (c) (1) provides for a credit only to the extent that "dividend" payments are restricted, and not to situations where the restriction is only in respect of "asset distribution" dividends. See *Columbia River Paper Mills v. Commissioner*, 43 B. T. A. 263, 266 (on appeal to C. C. A. 9th).

The decision of the court below is not in conflict with the decision of any other circuit court of appeals, and petitioner asserts no such conflict. Nor is it in conflict with the decision of the Board

of Tax Appeals in *Paraport Theatre Leasing Corp. v. Commissioner*, 44 B. T. A. 108. In that case the Board construed the word "dividends" in Section 26 (c) (1) as meaning "taxable dividends." In the instant case, petitioner, under the contract, was not prohibited from paying dividends in preferred stock on its common stock. There is, therefore, nothing to indicate that the dividend payments permitted by the contract were not taxable dividends.¹ Cf. *Kelly Trust v. Commissioner*, 38 B. T. A. 1014, affirmed by the Eighth Circuit on July 19, 1939 (see 1939 C. C. H., Vol. 4, Par. 9624), in an opinion which was subsequently withdrawn (106 F. (2d) 1002) because of Section 214 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, in accordance with a stipulation of the parties; *Keister v. Commissioner*, 42 B. T. A. 484 (on appeal to C. C. A. 9th); see *Koshland v. Helvering*, 298 U. S. 441; *Helvering v. Gowran*, 302 U. S. 238.

¹ Insofar as appears and insofar as we have been able to find, North Dakota law did not forbid petitioner from paying dividends in preferred stock on its common stock. And in any event, a dividend restriction deriving from statute would not seem to be the kind of restriction contemplated by Section 26 (c) (1). *Helvering v. Northwest Steel Mills*, 311 U. S. 46; *Crane-Johnson Co. v. Commissioner*, 311 U. S. 54.

CONCLUSION

The decision below is correct and there is no conflict. The petition should therefore be denied.

Respectfully submitted.

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